

Number: **201142016**
Release Date: 10/21/2011
Index Number: 115.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-142640-10

Date:
June 28, 2011

Authority =

Territory =

Property =

Secretary =

Department =

Office =

Parent =

Sub 1 =

Sub 2 =

Sub 3 =

Corp A =

Corp B =

State =

Statute =

Section X =

Dear :

This letter responds to a letter from your authorized representative dated October 1, 2010, submitted on behalf of the Authority, requesting rulings that (1) the Authority qualifies as a political subdivision of the Territory and, as such, is not subject to federal income taxation; and (2) the income derived from the operations of the limited liability companies owned by the Authority is excluded from gross income pursuant to § 115(2) of the Internal Revenue Code. The Authority represents the following facts.

ISSUE 1: § 103

FACTS

The Authority was formed under the Statute as a body corporate and politic, constituting a public corporation and governmental instrumentality of the Territory. Under this same law, certain goods, debts, and assets belonging to the Territory were transferred to the Authority, such as the Property.

Designated by law as a public utility, the Authority was created to promote the general welfare and increase commerce by conserving, developing, and utilizing the Territory's water and energy resources so as to make those resources available to Territory residents. In keeping with these objectives, the Authority generates and transmits electricity in the Territory.

The Authority's governing board has nine members: one, serving *ex officio*, is the Secretary, six are appointed by the governor of the Territory, and two are consumer representatives elected through a referendum supervised by the Department.

The Authority's funds are deposited into qualified depositories for funds of the Territory government, but are kept in a separate account in the name of the Authority. The Authority disburses these funds according to regulations and budgets approved by its governing board. The Authority is subject to audit by the Office, and each year it must submit to the Territory's legislature and governor a financial statement and complete report of its business activities.

The Authority is authorized by Territory law to acquire property by eminent domain. Other than certain procedural safeguards, such as those dealing with due process, proper venue, and just compensation, this power is not limited. The Authority may initiate eminent domain actions in its own name.

LAW AND ANALYSIS

Section 1.103-1(b) of the Income Tax Regulations defines the term “political subdivision” as any division of a state or local governmental unit that is a municipal corporation or has been delegated the right to exercise part of the sovereign power of the governmental entity. A political subdivision of a state or local government might include special assessment districts for such things as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, and port improvement.

Three generally acknowledged sovereign powers are the power to tax, the power of eminent domain, and the police power. Commissioner v. Estate of Alexander V. Shamberg, 3 T.C. 131 (1944); acq., 1945 C.B. 6; aff’d, 144 F.2d 998 (2d Cir. 1944); cert. denied, 323 U.S. 792 (1945). An entity need not have all three powers for it to be a political subdivision; however, possession of only an insubstantial amount of any or all of the sovereign powers would be insufficient for this purpose. All facts and circumstances must be taken into account, including the entity’s public purposes and its control by a government. Rev. Rul. 77-164, 1977-1 C.B. 20.

The Authority has a wholly public purpose, is effectively controlled by the Territory, and has been delegated the full power of eminent domain, making it a political subdivision of the Territory. See the private letter ruling issued to the Authority in 2006 (PLR 200635009).

ISSUE 2 - § 115(2)

FACTS

In line with the analysis above regarding § 103, the Authority is a political subdivision of the Territory.

The Authority is authorized under Territory law to create subsidiaries or other entities and affiliates to develop, finance, construct, and operate industrial projects and other infrastructure directly related to maximizing the Authority’s electric infrastructure. Accordingly, the Authority created a number of subsidiary corporations, organized as single-member limited liability companies (LLCs) under the law of State (Sub 1, Sub 2,

and Parent, with Parent creating Sub 3 as a single-member LLC by authority granted it by the Authority). Each LLC was created to serve a different purpose in support of the Authority's operations.

Sub 1 and Sub 2 were created by the Authority, with the Authority as their sole member. Members of the boards of managers for Subs 1 and 2 are appointed by the governing board of the Authority.

The operations of Corp A, wholly-owned by Parent, and Corp B, wholly-owned by Corp A, will be merged into the operations of Sub 2.

Parent was created by the Authority, with the Authority as its sole member and as the sole entity with the power to designate and remove members of Parent's board of managers. The Authority transferred to Parent its ownership interests in Sub 1, Sub 2, Corp A, and two inactive LLCs.

Sub 3 was created by Parent, with Parent as its sole member.

Subs 1, 2, and 3 each filed IRS Form SS-4, Application for Employer Identification Number, electing to be treated for federal income tax purposes as a disregarded entity.

Parent was formed under articles (similar to the articles under which the other LLCs were formed) mandating that, upon dissolution, the title to all property owned by Parent shall vest in, and become the property of, the Authority, or the board or body which by law succeeds to the functions and powers of the Authority. Under its articles of formation, no part of the net earnings of Parent may inure to the benefit of any member (except for the Authority), trustee, or officer of Parent or of any private person, and no member (except for the Authority), trustee, or officer of Parent or any other individual may share in the distribution of any assets upon dissolution of Parent.

The Authority and Parent will sign an operating agreement setting forth the standards and procedures governing the affairs of Parent and the conduct of its business. Parent's board of managers will be comprised of three members who are also members of the Authority's governing board, and three members who are private citizens appointed by the Authority. The operating agreement may be modified or amended only with the written approval of the Authority.

It is expected that Parent will execute operating agreements with Subs 1, 2, and 3 similar to the one it will have with the Authority. Authority intends to develop intercompany programs to maximize the efficient use of resources among the group.

LAW & ANALYSIS

Section 115(2) provides that gross income does not include income accruing to the government of any possession of the United States, or any political subdivision thereof.

Section X provides that, with certain exceptions not here relevant, references in the Code to United States possessions shall be treated as also referring to the Territory.

Section 301.7701-2(a) of the Procedure and Administration Regulations provides that a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not property classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Section 301.7701-2(b) provides that the term corporation for federal tax purposes means (1) a business entity organized under a federal or state statute that describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic; or (5) a business entity wholly owned by a state or any political subdivision thereof.

Section 301.7701-3(a) provides that a business entity with a single owner that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) may elect to be classified as an association to be disregarded as an entity separate from its owner.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) was excludable from gross income under § 115. In Rev. Rul. 90-74, private interests neither materially participated in the organization nor benefited more than incidentally from the organization.

Parent, wholly owned by a political subdivision, is engaged through wholly-owned and disregarded subsidiaries in the operation of a public utility and related activities. Such operations and activities represent the participation of the Territory in enterprises that are useful in carrying out projects desirable to the Territory's government and which are within the ambit of a sovereign properly to conduct. See Rev. Rul. 77-261.

The income generated by the operations and activities of Parent through its wholly-owned and disregarded subsidiaries accrues only to the Authority, which is a political subdivision of the Territory. The Parent's articles of formation state that no part of the net earnings of the entity shall inure to the benefit of any member (other than the Authority), trustee, or officer of the Parent; and upon Parent's dissolution, all of Parent's property will become the property of the Authority or of any lawful successor. See Rev. Rul. 90-74.

CONCLUSIONS

Based solely on the facts and representations submitted by the Authority:

1. We conclude that the Authority qualifies under § 103 as a political subdivision of the Territory, a possession of the United States, and, as such, is not subject to federal income taxation.
2. We conclude that the income from the operation of the LLCs owned by Parent, which is wholly-owned by the Authority, will accrue to the government of a possession of the United States or a political subdivision thereof for purposes of § 115(2). Consequently, we rule that Parent's income from Sub 1, Sub 2, and Sub 3 is excludable from gross income under § 115(2).

Except for the specific rulings above, no opinion is expressed or implied regarding the federal tax consequences of the facts of this case under any other provision of the Code.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT
Assistant Chief
Exempt Organizations Branch 2
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt & Government Entities)

enclosures: copy for § 6110 purposes

cc: